

ORIGINAL



0000076219

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson  
Director  
Utilities Division

EA for EGJ

DATE: September 5, 2007

RE: IN THE MATTER OF THE APPLICATION OF MATRIX TELECOM, INC. FOR  
APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY TO  
PROVIDE INTRASTATE TELECOMMUNICATIONS SERVICES (DOCKET NO.  
T-03228A-06-0800)

Arizona Corporation Commission

DOCKETED

SEP 05 2007

DOCKETED BY	
-------------	--

Attached is the Staff Report for the above referenced application. The Applicant is applying for approval to provide the following services:

- Facilities-Based Local Exchange Services

Staff is recommending approval of the application.

EGJ:WMS:lhv\KT

Originator: Wilfred Shand, Jr.

RECEIVED

2007 SEP -5 P 4: 42

AZ CORP COMMISSION  
DOCKET CONTROL

SERVICE LIST FOR: MATRIX TELECOM, INC.  
DOCKET NO.: T-03228A-06-0800

Mr. Scott Klopach  
Vice President, Regulatory Affairs & General Counsel  
Matrix Telecom, Inc. dba Matrix Business Technologies  
7171 Forest Lane, Suite. 700  
Dallas, Texas 75230

Ms. Judith A. Riley, President  
Telecom Professionals, Inc.  
5909 Northwest Expressway, Suite 403  
Oklahoma City, Oklahoma 73132

Mr. Christopher C. Kempley  
Chief Counsel, Legal Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Mr. Ernest G. Johnson  
Director, Utilities Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

Ms. Lyn Farmer  
Chief Administrative Law Judge, Hearing Division  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona 85007

STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION

MATRIX TELECOM, INC.  
DOCKET NO.: T-03228A-06-0800

IN THE MATTER OF THE APPLICATION OF MATRIX TELECOM, INC.  
FOR APPROVAL OF A CERTIFICATE OF CONVENIENCE AND NECESSITY  
TO PROVIDE INTRASTATE TELECOMMUNICATIONS SERVICES


September 5, 2007

## **TABLE OF CONTENTS**

1.	INTRODUCTION .....	1
2.	TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES .....	1
3.	FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES .....	1
4.	ESTABLISHING RATES AND CHARGES .....	2
5.	LOCAL EXCHANGE CARRIER SPECIFIC ISSUES .....	2
5.1	NUMBER PORTABILITY .....	3
5.2	PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE....	3
5.3	QUALITY OF SERVICE .....	3
5.4	ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS .....	3
5.5	911 SERVICE.....	4
5.6	CUSTOM LOCAL AREA SIGNALING SERVICES .....	4
7.	COMPETITIVE SERVICES ANALYSIS .....	6
7.1	COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES ...	6
8.	RECOMMENDATIONS .....	8
8.1	RECOMMENDATIONS ON THE APPLICATION FOR A CC&N .....	8
8.2	RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE .....	9

## STAFF ACKNOWLEDGEMENT

The Staff Report for the Application of Matrix Telecom, Inc. for approval of a Certificate of Convenience and Necessity to provide Intrastate Telecommunications Services (Docket No. T-03228A-06-0800) was the responsibility of the staff member listed below. Wilfred Shand, Jr. was responsible for the review and analysis of the application.

  
\_\_\_\_\_  
Wilfred Shand, Jr.  
Public Utilities Analyst Manager

## **1. INTRODUCTION**

On December 26, 2006, Matrix Telecom, Inc. d/b/a Matrix Business Technologies ("MTI" or "Matrix") filed an application for a Certificate of Convenience and Necessity ("CC&N") to provide facilities-based local exchange service within the State of Arizona. The Applicant petitioned the Arizona Corporation Commission ("Commission") for a determination that its proposed services should be classified as competitive.

On January 25, 2007, Staff mailed its Letter of Insufficiency and First Set of Data Requests to MTI. MTI responded to the First Set of Data Requests on May 17, 2007. Staff mailed additional Sets of Data Requests on June 6, 2007 and July 18, 2007.

Staff's review of this application addresses the overall fitness of the Applicant to receive a CC&N. Staff's analysis also considers whether the Applicant's services should be classified as competitive and if the Applicant's initial rates are just and reasonable.

## **2. TECHNICAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES**

MTI indicated that it is currently providing resold local exchange in 44 states including Arizona and resold long distance service nationwide excluding Arizona. Based on this, Staff believes MTI possesses the technical capabilities to provide the services it is requesting the authority to provide.

## **3. FINANCIAL CAPABILITY TO PROVIDE THE REQUESTED SERVICES**

The Applicant provided unaudited financial statements for the period ending December 31, 2007. These financial statements list assets in excess of \$25 million, negative equity in excess of \$15 million and net income in excess of \$4 million. The Applicant did not provide notes related to the financial statements.

The Applicant stated in its application that it does not plan to collect deposits from its local exchange service customers. Since the Applicant is requesting a CC&N for facilities-based local exchange service, Staff recommends that Matrix increase its existing performance bond or sight draft Letter of Credit by \$100,000. Staff further recommends that the existing Matrix requirement that the bond or Letter of Credit coverage needs to increase in increments equal to 50 percent of the total minimum bond amount when the total amount of the advances, deposits, and prepayments is within 10 percent of the total minimum bond amount. Further, measures should be taken to ensure that the Applicant will not discontinue service to its customers without first complying with Arizona Administrative Code ("A.A.C.") R14-2-1107.

Staff recommends that the Applicant procure a performance bond or irrevocable sight draft Letter of Credit equal to \$125,000. The minimum bond or irrevocable sight draft Letter of Credit amount of \$125,000 should be increased if at any time it would be insufficient to cover prepayments or deposits collected from the Applicant's customers. The bond or irrevocable

sight draft Letter of Credit amount should be increased in increments of \$62,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$12,500 of the bond or irrevocable sight draft Letter of Credit amount. If the Applicant desires to discontinue service, it must file an application with the Commission pursuant to A.A.C. R14-2-1107. Additionally, the Applicant must notify each of its customers and the Commission 60 days prior to filing an application to discontinue service. Failure to meet this requirement should result in forfeiture of the Applicant's performance bond or irrevocable sight draft Letter of Credit. Staff further recommends that proof of the above mentioned performance bond or irrevocable sight draft Letter of Credit be docketed within 365 days of the effective date of an order in this matter or 30 days prior to the provision of service, whichever comes first, and that it remain in effect until further order of the Commission.

#### **4. ESTABLISHING RATES AND CHARGES**

The Applicant would initially be providing service in areas where an incumbent local exchange carrier ("ILEC"), along with various competitive local exchange carriers ("CLECs") and interexchange carriers are providing telephone service. Therefore, the Applicant would have to compete with those providers in order to obtain subscribers to its services. The Applicant would be a new entrant and would face competition from both an incumbent provider and other competitive providers in offering service to its potential customers. Therefore, the Applicant would generally not be able to exert market power. Thus, the competitive process should result in rates that are just and reasonable.

Both an initial rate (the actual rate to be charged) and a maximum rate must be listed for each competitive service offered, provided that the rate for the service is not less than the Company's total service long-run incremental cost of providing the service pursuant to A.A.C. R14-2-1109.

The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company indicating that its fair value rate base is zero. Accordingly, the company's fair value rate base is too small to be useful in a fair value analysis. Staff has reviewed these rates and believes they are comparable to the rates charged by competitive local carriers, local incumbent carriers and major long distance carriers operating in the State of Arizona. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value rate base information provided should not be given substantial weight in this analysis.

#### **5. LOCAL EXCHANGE CARRIER SPECIFIC ISSUES**

Issues related to the provision of that Local Exchange service are discussed below.

### **5.1    *NUMBER PORTABILITY***

The Commission has adopted rules to address number portability in a competitive telecommunications services market. Local exchange competition may not be vigorous if customers, especially business customers, must change their telephone numbers to take advantage of a competitive local exchange carrier's service offerings. Consistent with federal laws, federal rules and A.A.C. R14-2-1308(A), the Applicant shall make number portability available to facilitate the ability of a customer to switch between authorized local carriers within a given wire center without changing their telephone number and without impairment to quality, functionality, reliability or convenience of use.

### **5.2    *PROVISION OF BASIC TELEPHONE SERVICE AND UNIVERSAL SERVICE***

The Commission has adopted rules to address universal telephone service in Arizona. A.A.C. R14-2-1204(A) indicates that all telecommunications service providers that interconnect into the public switched network shall provide funding for the Arizona Universal Service Fund ("AUSF"). The Applicant will make the necessary monthly payments required by A.A.C. R14-2-1204(B).

### **5.3    *QUALITY OF SERVICE***

Staff believes that the Applicant should be ordered to abide by the quality of service standards that were approved by the Commission for Qwest (fka USWC) in Docket No. T 01051B-93-0183 (Decision No. 59421). Because the penalties developed in that docket were initiated because Qwest's level of service was not satisfactory and the Applicant does not have a similar history of service quality problems, Staff does not recommend that those penalties apply to the Applicant. In the competitive market that the Applicant wishes to enter, the Applicant generally will have no market power and will be forced to provide a satisfactory level of service or risk losing its customers. Therefore, Staff believes that it is unnecessary to subject the Applicant to those penalties at this time.

### **5.4    *ACCESS TO ALTERNATIVE LOCAL EXCHANGE SERVICE PROVIDERS***

Staff expects that there will be new entrant providers of local exchange service who will install the plant necessary to provide telephone service to, for example, a residential subdivision or an industrial park much like existing local exchange companies do today. There may be areas where the Applicant installs the only local exchange service facilities. In the interest of providing competitive alternatives to the Applicant's local exchange service customers, Staff recommends that the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve such areas. This way, an alternative local exchange service provider may serve a customer if the customer so desires. Access to other providers should be provided pursuant to the provisions of the 1996 Telecommunications Act, the rules promulgated there under and Commission rules on interconnection and unbundling.



## **5.5 911 SERVICE**

The Commission has adopted rules to address 911 and E911 services in a competitive telecommunications services market. The Applicant has certified that in accordance with A.A.C. R14-2-1201(6)(d) and Federal Communications Commission 47 CFR Sections 64.3001 and 64.3002, it will provide all customers with 911 and E911 service, where available, or will coordinate with ILECs and emergency service providers to provide 911 and E911 service.

## **5.6 CUSTOM LOCAL AREA SIGNALING SERVICES**

Consistent with past Commission decisions, the Applicant may offer Caller ID provided that per call and line blocking, with the capability to toggle between blocking and unblocking the transmission of the telephone number, are provided as options to which customers could subscribe with no charge. Also, Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated, indicating that the number has been blocked, must be offered.

## **6. REVIEW OF COMPLAINT INFORMATION**

The Applicant stated that it has neither had an application for service denied, nor revoked in any state. In its Application, Matrix also provided the following information which stated that:

1. Since 2001, the Federal Communications Commission ("FCC") has issued 13 orders resolving informal complaints from subscribers against Matrix. Each of these complaints alleged that Matrix had switched the subscriber's primary interexchange carrier without proper authorization. The FCC denied or found to be resolved nine of these 13 complaints. Of the remaining four, three found a technical violation of the FCC's "slamming" rules which resulted from Matrix's reliance on a third party to verify the subscriber's intent to switch his or her carrier to Matrix. In these three cases, the third party failed to confirm the telephone number to be switched. Matrix no longer uses the services of this third party verification provider. The remaining case involved a customer transferred to Matrix after his chosen carrier went out of business.
2. In 2001, the FCC issued an Order of Forfeiture, finding that Matrix had violated Section 254(d) of the Communications Act of 1934, as amended, 47 U.S.C. § 254(d), and Section 54.706 of the Commission's rules, 47 C.F.R. § 54.706, by failing to make required contributions to universal service support programs. See Matrix Telecom, Inc., File No. EB -00-M-0057, Forfeiture Order, FCC 01-48, 16 FCC Rcd 10553. The events that led to this Order took place prior to Platinum Equity's acquisition of Matrix, and under prior management. In its Order, the FCC cited with approval the efforts of the new Platinum Equity ownership and management both to put in place remedial compliance measures and to pay

overdue amounts. In view of these efforts, the FCC reduced the base forfeiture amount it otherwise would have imposed by over 40 percent.

3. Matrix is periodically the subject of informal customer complaints filed before state public utility commissions. There were 22 such complaints filed in 2005 and 28 such complaints filed in 2006. These generally concern minor billing issues or service questions. All but one of these complaints has been resolved. In the remaining case, Matrix has requested additional information from the customer and is awaiting a response.

Matrix also indicated that NextiraOne, a former subsidiary of Platinum Equity, Matrix parent company, had pled guilty to charges of wire fraud for overbilling the U.S. government for the services actually provided to the tribes (a copy of the plea agreement was attached to the Application as Exhibit F).

The following information is contained in the plea agreement which was attached to the Application as Exhibit F:

*(a.) For the purposes of this Plea Agreement, the "relevant period" encompasses from at least December, 2000, through at least December, 2002. Williams Communications Solutions ("WCS") was acquired by Platinum Equity, LLC ("Platinum Equity") in April 2001, and the name of the business was changed to Nextira and later NextiraOne. At the time of the acquisition, WCS was engaged in the design, sale, and maintenance of advanced voice and data networks.*

...

*(q.) The events described above occurred prior to the arrival of current senior management of NextiraOne in May 2003. Under its new management, NextiraOne reorganized its sales force and adopted a Code of Business Ethics and Conduct; it also dismantled its E-rate consulting services business unit. NextiraOne has cooperated with the United States' investigation. NextiraOne has made its current employees available for interviews by the United States and, pursuant to a subpoena, it has produced voluminous corporate records in hard copy and electronic format to the United States. Cite Factual Basis for Offense Charged (q.) of the plea agreement.*

NextiraOne was required to pay a fine of \$1,818,380 and to shall release claims totaling \$2.6 million to the FCC.

Matrix further stated in its application that:

1. Paul Bird, who was at the time of the application was Matrix's Sr. Vice President of Technology, was employed with NextiraOne from 1993 to March 1, 2006 as the Director of Networks. During 2001, Mr. Bird and his team designed the telecommunications platform that would allow certain native-American tribes to

access the Internet. The U.S. government has a program for funding such telecommunications services for school and libraries.

2. On April 20, 2006, NextiraOne pled guilty to charges of wire fraud for overbilling the U.S. government for the services actually provided to the tribes (a copy of the plea agreement was attached to the Application as Exhibit F). Matrix stated that neither Mr. Bird nor his team were involved with submitting invoices to either the United States or the tribes.

In MTI's response to Staff Data Request WMS3-6, Mr. Bird was not included in the list of former officers or employees of NextiraOne that currently hold positions as officers or employees of Platinum Equity or one or more of its portfolio companies, or both.

Based on information received from Matrix in responses to Staff Data Requests WMS3-6 and WMS4-1, one current officer of a Matrix Telecom, Inc. Eva M. Kalawski, a Director, a Vice President and the Secretary of MTI, was employed (for about ten months) by NextiraOne during the December 2000 to December 2002 (the relevant period in the plea agreement). Eva M. Kalawski served as Vice President and Secretary at NextiraOne from April 2002 to April 2006 when the company was sold.

## **7. COMPETITIVE SERVICES ANALYSIS**

The Applicant has petitioned the Commission for a determination that the local exchange services it is seeking to provide should be classified as competitive.

### **7.1 COMPETITIVE SERVICES ANALYSIS FOR LOCAL EXCHANGE SERVICES**

#### **7.1.1 A description of the general economic conditions that exist, which makes the relevant market for the service one that, is competitive.**

The local exchange market that the Applicant seeks to enter is one in which a number of new CLECs have been authorized to provide local exchange service. Nevertheless, ILECs hold a virtual monopoly in the local exchange service market. At locations where ILECs provide local exchange service, the Applicant will be entering the market as an alternative provider of local exchange service and, as such, the Applicant will have to compete with those companies in order to obtain customers. In areas where ILECs do not serve customers, the Applicant may have to convince developers to allow it to provide service to their developments.

#### **7.1.2 The number of alternative providers of the service.**

Qwest and various independent LECs are the primary providers of local exchange service in the State. Several CLECs and local exchange resellers are also providing local exchange service.

**7.1.3 The estimated market share held by each alternative provider of the service.**

Since Qwest and the independent LECs are the primary providers of local exchange service in the State, they have a large share of the market. Since the CLEO and local exchange resellers have only recently been authorized to offer service they have limited market share.

**7.1.4 The names and addresses of any alternative providers of the service that are also affiliates of the telecommunications Applicant, as defined in A.A.C. R14-2-801.**

None.

**7.1.5 The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions.**

ILECs have the ability to offer the same services that the Applicant has requested in their respective service territories. Similarly many of the CLECs and local exchange resellers also offer substantially similar services.

**7.1.6 Other indicators of market power, which may include growth and shifts in market share, ease of entry and exit, and any affiliation between and among alternative providers of the service(s).**

The local exchange service market is:

- a. One in which ILECs own networks that reach nearly every residence and business in their service territories and which provide them with a virtual monopoly over local exchange service. New entrants are also beginning to enter this market.
- b. One in which new entrants will be dependent upon ILECs:
  1. To terminate traffic to customers.
  2. To provide essential local exchange service elements until the entrant's own network has been built.
  3. For interconnection.
- c. One in which ILECs have had an existing relationship with their customers that the new entrants will have to overcome if they want to compete in the market and one in which new entrants do not have a long history with any customers.
- d. One in which most customers have few, if any choices since there is generally only one provider of local exchange service in each service territory.

- e. One in which the Applicant will not have the capability to adversely affect prices or restrict output to the detriment of telephone service subscribers.

## **8. RECOMMENDATIONS**

The following sections contain the Staff recommendations on the application for a CC&N and the Applicant's petition for a Commission determination that its proposed local exchange services should be classified as competitive.

### **8.1 RECOMMENDATIONS ON THE APPLICATION FOR A CC&N**

Staff recommends that Applicant's application for a CC&N to provide local exchange services be granted. Staff further recommends:

1. That the Applicant complies with all Commission Rules, Orders and other requirements relevant to the provision of intrastate telecommunications services;
2. That the Applicant abides by the quality of service standards that were approved by the Commission for Qwest in Docket No. T-01051B-93-0183;
3. That the Applicant be prohibited from barring access to alternative local exchange service providers who wish to serve areas where the Applicant is the only provider of local exchange service facilities;
4. That the Applicant be required to notify the Commission immediately upon changes to the Applicant's name, address or telephone number;
5. That the Applicant cooperate with Commission investigations including, but not limited to customer complaints;
6. The rates proposed by this filing are for competitive services. In general, rates for competitive services are not set according to rate of return regulation. Staff obtained information from the company and has determined that its fair value rate base is zero. Staff has reviewed the rates to be charged by the Applicant and believes they are just and reasonable as they are comparable to other competitive local carriers offering service in Arizona and comparable to the rates the Applicant charges in other jurisdictions. The rate to be ultimately charged by the company will be heavily influenced by the market. Therefore, while Staff considered the fair value rate base information submitted by the company, the fair value information provided was not given substantial weight in this analysis;
7. That the Applicant offer Caller ID with the capability to toggle between blocking and unblocking the transmission of the telephone number at no charge;

8. That the Applicant offer Last Call Return service that will not return calls to telephone numbers that have the privacy indicator activated;
9. Staff further recommends that the Commission authorize the Applicant to discount its rates and service charges to the marginal cost of providing the services;

Staff further recommends that the Applicant be ordered to comply with the following. If it does not do so, the Applicant's CC&N shall be null and void, after due process.

1. The Applicant shall docket conforming tariffs for local exchange service within 365 days from the date of an Order in this matter or 30 days prior to providing service, whichever comes first. The tariffs submitted shall coincide with the application.
2. The Applicant shall:
  - a. Procure, at its discretion, either a performance bond or an irrevocable sight draft Letter of Credit equal to \$125,000. The minimum bond or irrevocable sight draft Letter of Credit amount of \$125,000 should be increased if at any time it would be insufficient to cover advances, deposits, and/or prepayments collected from the Applicant's customers. The bond or irrevocable sight draft Letter of Credit amount should be increased in increments of \$62,500. This increase should occur when the total amount of the advances, deposits, and prepayments is within \$12,500 of the bond or irrevocable sight draft Letter of Credit amount.
  - b. Docket proof of the performance bond or irrevocable sight draft Letter of Credit within 365 days of the effective date of an Order in this matter or 30 days prior to the provision of service, whichever comes first. The performance bond or irrevocable sight draft Letter of Credit must remain in effect until further order of the Commission.

## **8.2 RECOMMENDATION ON THE APPLICANT'S PETITION TO HAVE ITS PROPOSED SERVICES CLASSIFIED AS COMPETITIVE**

Staff believes that the Applicant's proposed services should be classified as competitive. There are alternatives to the Applicant's services. The Applicant will have to convince customers to purchase its services, and the Applicant has no ability to adversely affect the local exchange markets. Therefore, the Applicant currently has no market power in the local exchange markets where alternative providers of telecommunications services exist. Staff therefore recommends that the Applicant's proposed services be classified as competitive.